COMMONWEALTH OF MASSACHUSETTS

before the

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Western Massachusetts Electric Company) D.T.E. 00-33

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INITIAL BRIEF OF THE ATTORNEY GENERAL

Respectfully submitted,

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INTRODUCTION

As required by G. L. c. 164, §§ 1-2 ("the Restructuring Act"), on December 31, 1997, Western Massachusetts Electric Company ("WMECo" or "Company") filed an Electric Restructuring Plan ("Plan") with the Department of Telecommunications and Energy ("Department"). The Plan, docketed as D.T.E. 97-120, offered the Company's retail customers competitive electric generation service and requested recovery of transition costs related to the Company's investment in nuclear, fossil fuel and hydroelectric generating units. In its decision, the Department deferred making findings concerning the treatment of certain proposed plant transition costs, including pension over-funding and post-retirement benefits, until divestiture.

Western Massachusetts Electric Company, D.T.E. 97-120, pp. 62-76 (1999).

In the filing now under consideration, the Company's first transition charge reconciliation since the decision in its restructuring docket, WMECo proposes an unfair reconciliation of the pension over-funding and post-retirement benefit issues. In addition, the Company's treatment of the investment tax credit ("ITC") and Tariff T-9 charges associated with the sale of the West Springfield hydroelectric plants do not provide for the "maximum possible mitigation," as required by the Restructuring Act.

STATEMENT OF THE CASE
On March 31, 2000, WMECo filed a request for a Transition Charge Reconciliation covering the period March 1, 1998, through December 31, 1999.(1) On June 30, 2000, WMECo and the Attorney General submitted a comprehensive Joint Settlement agreement regarding docket D.T.E. 97-120 (Phase 2) associated with post-1995 capital additions; certain outstanding generating unit performance review dockets (D.P.U. 96-8C-1; D.P.U. 97-8C-1; D.P.U. 98-8C-1; D.P.U. 98-8C-1, D.T.E. 99-8C-1) and the Northeast Utilities Generation and Transmission ("NUG&T") termination docket pending before the Federal Energy Regulatory Commission, ER99-3196. After issuing an Order of Notice and requesting comments, the Department approved the Settlement, which, inter alia, terminated several, but not all, of the issues relevant to this proceeding.

By Order of Notice dated October 31, 2000, the Department scheduled a public hearing and a procedural conference for November 17, 2000, to address the remaining issues in the Company's amended petition. On January 19, 2001, the Company filed the testimony of John P. Stack and on January 24, 2001, the Attorney General submitted the testimony of David Effron. The Company responded with rebuttal testimony of both Mr. Stack and Robert A. Baumann which prompted the Attorney General to filed surrebuttal testimony from Mr. Effron on April 13, 2001. Evidentiary hearings were held on May 1-3, 2001. At these hearings the Company presented a panel of two witnesses: Robert A. Baumann, manager of revenue requirements, and John P. Stack. The Attorney General presented David Effron, a recognized regulatory expert.

STANDARD OF REVIEW
The Restructuring Act sets forth the standard of review that the Department must employ in this proceeding. It requires the Department to "identify and determine . . . those costs and categories of costs for generation-related assets, investments, and obligations . . . which may be allowed to be recovered through a non-bypassable transition charge. . . ." G.L. c. 164, §1G(a)(1). In addition to the specifically identified labor and tax costs, the Restructuring Act provides that transition costs "shall include only the following:"

(1) "costs for generation-related assets and obligations . . . that become uneconomic as a result of the creation of a competitive generation market," G.L. c. 164, §1G(b)(1)(i);

(2) "the department-authorized recovery for nuclear entitlements," G.L. c. 164, §1G(b)(1)(ii);

(3) "the unrecovered amount of the reported book balances of existing generation-related regulatory assets," G.L. c. 164, §1G(b)(1)(iii); and,

(4) "the amount by which the costs of existing contractual commitments for purchased

power exceeds the competitive market price for such power," G.L. c. 164, §1G(b)(1)(iv).

The Department must review the filings to "ensure that the proposed reconciliations are consistent with or substantially comply with the Restructuring Act, the Company's approved restructuring plan, applicable law, and Department precedent." Boston Edison Company, D.T.E. 98-111, p. 4 (1999) (reconciliation settlement approval under the Restructuring Act). Nothing in the Restructuring Act can be construed as relieving the Company of its duty to prove, by substantial evidence, compliance with these requirements. "Transition costs" are determined by the Department only after "accounting for maximum possible mitigation." G. L. c. 164, § 1 (emphasis added).

ARGUMENT

THE DEPARTMENT SHOULD REJECT WMECo'S ATTEMPT TO SHIFT GENERATION RELATED FAS 106 COSTS TO CUSTOMERS CONTRARY TO THE ORDER IN D.T.E. 97-120

The Department should reject WMECo's attempt to saddle its customers with a disproportionate share of responsibility for the generation related balance of its so-called Financial Accounting Standard ("FAS") 106 Transition Obligation.(2) In particular, the Company proposed and the Department approved recognition of a regulatory asset in the amount of $8,175,000 as the generation related portion of its estimated March 1, 1998 overall FAS 106 Transition Obligation for WMECo, including an allocation from its service company, Northeast Utilities Service Corporation ("NUSCo"), and from Northeast Nuclear Energy Company ("NNECo"). The allocation to WMECo generation is based on the ratio of active employees engaged in generation related activities to total employees. In this reconciliation filing, however, with the fossil/hydro divestiture, WMECo now proposes to credit to its customers for only $60,000 or 1 percent of the actuarial gains on the transition obligation balance for WMECo's own generation-related employees and none of the actuarial gains on the transition obligation balance for its share of NUSCo's generation-related employees. Exh. AG1-25. This is in direct contravention of the Department's earlier decision. The Department expressly found "that the reconciliation of the FAS 106 balance should include the effect of actuarial gains and losses." Western Massachusetts Electric Company, D.T.E. 97-120, p. 66 (1999). The Company's argument, however, that 1) Mr. Effron is not an actuary and therefore does not "understand" the calculations, and 2) the actual number of employees eligible for post-retirement benefits other than pensions as a result of the divestiture is different from the allocated number used by Mr. Effron is utterly devoid of merit and should be rejected by the Department. Exh. WM-5, p. 15.

Introduction

The Company in its original restructuring plan proposed to include as a transition cost a regulatory asset, the FAS 106 Transition Obligation (Exh. WM-2, Att. Exhibit RAB-4, pages 6 and 12C). This regulatory asset represents the FAS 106 Transition Obligation determined as of January 1, 1993 amortized through March 1, 1998. Tr. 2, p. 281 and Tr. 1, p. 12. The balance recovered in the transition charge by WMECo includes the generation related portion of the WMECo Transition Obligation (allocated based on the number of active employees) and allocations from NUSCo and NNECO. Exh. AG IR-01-25). The estimate of the Transition Obligation at the time of the adoption of FAS 106, January 1, 1993, included many estimates and assumptions. Those estimates and assumptions were subject to refinement and true-up in subsequent actuarial studies quantifying the FAS 106 obligation. Tr. 2, pp. 281-282.

The Company's proposal in this case, however, asks the Department to retain the recovery of the full amount of the FAS 106 Transition Obligation regulatory asset for the generation-related employees as determined in the Company's originally filed plan, but to base the "reconciliation" on the one employee that its actuaries "specifically identified" as having retired as a result of the divestiture. As will be discussed below, the Company's new proposal is not only inconsistent with its own original proposal and the Department's findings associated with the Company's original proposal, it is also illogical and internally inconsistent.

The Department Should Reject WMECo Attempt To Limit Recognition of Actuarial Gains Related To FAS 106 Generation-Related Transition Obligation

The Department properly recognized the dubious nature of the Company's estimates in its restructuring order, expressing its "serious concerns regarding the uncertainties surrounding FAS 106" and directing that "[a]t the time of each divestiture, WMECo shall reconcile the FAS 106 balance for the appropriate share of the unrecognized transition obligation, unrecognized prior service cost and unrecognized gains or losses associated with the FAS 106 obligation." D.T.E. 97-120, p. 66. The Department recognized that what must be reconciled is the FAS 106 Transition Obligation included by the Company as a regulatory asset in the transition charge. Id.

In its filing, the Company has included a FAS 106 regulatory asset in the transition charge equal to 26.25% of the WMECo FAS 106 Transition Obligation as of March 1, 1998, based on the ratio of active WMECo generation employees to total WMECo employees. Exh. AG IR-01-25. Thus, to achieve a proper reconciliation of the FAS 106 Transition Obligation for unrecognized gains or losses, that reconciliation also must, as a matter of simple arithmetic, include 26.25% of such unrecognized gains or losses. This is necessary to achieve compliance with the plain language of the Department's order as well as the principles of consistency and logic.

Mr. Effron explained how the reconciliation of the FAS 106 Transition Obligation should be reconciled for the effect of actuarial gains and losses:

At the time of the divestiture, the FAS 106 unrecognized net gain was $6,715,000. The appropriate share of this unrecognized net gain should be included in the FAS 106 adjustment related to the Fossil/Hydro divestiture in July 1999. . . .

Based on the percentage of WMECo generation employees, 26.25% of the FAS 106 unrecognized net gain, or $1,763,000 is allocable to generation…. (T)here were 38 generation employees, or 28.63% of the 132 total WMECo generation employees, associated with the July 1999 divestiture. Thus, 28.63%, or $505,000, of the FAS 106 unrecognized net gain allocable to WMECo generation should be credited to the Reconciliation Account as the FAS 106 adjustment related to the July 1999 divestiture (my Exhibit DJE-1, Page 3). It is important to note that this method of calculating the appropriate share of the FAS 106 unrecognized gain is precisely consistent with the method used by the Company to assign the FAS 106 transition obligation to WMECo generation.

Exh. AG -1, pp.11-12. This method of reconciling the FAS 106 balance is not only consistent with the method used by the Company to assign the FAS 106 transition obligation to WMECo generation, it is also consistent with the Department order in D.T.E. 97-120.

The Company's attempt to limit the reconciliation to the actuarial gain associated with one employee departing at the time of the divestiture, (Exh. WM-5, p. 16, ll. 19-20) is nothing less than an effort to rewrite the Department's order. The Company's witnesses insist that it is perfectly appropriate to allocate 26.25% of the WMECo FAS 106 Transition Obligation to the transition charges based on 132 WMECo generation employees but to reconcile this amount for only one employee leaving at the time of divestiture.(3) Exh. AG IR-01-25. What is missing from the record is any explanation of (1) why this obvious mismatch is appropriate or why the Department's order in D.T.E. 97-120 should be overturned; (2) why it is appropriate to include the FAS 106 Transition Obligation associated with retired employees in the transition charge, but to ignore the actuarial gains directly related to that Transition Obligation when subsequent actuarial studies have found the original estimate of the Transition Obligation to be overstated; and (3) why it is appropriate to include all active employees in the allocation of the FAS 106

Transition Obligation to WMECo generation but to claim that the great majority of those employees are ineligible for post retirement benefits when calculating the actuarial gain to be allocated to the transition charge. Tr. 1, pp. 34 and 43, ll. 1-5 and 22-24. (Exh. WM-5, p. 16).(4)

As Mr. Effron stated, "[t]o limit the FAS 106 adjustment as Mr. Baumann proposes would defeat the purpose of truing up the FAS 106 obligation that went into transition charge." Exh. AG-2, pp. 10, ll. 12-14. The effects of changes in actuarial assumptions since the time that the Transition Obligation was established appear in the reconciliation of the funded status of the post-retirement benefit obligation as unrecognized gains or losses. See, for example, Exh. AG-IR-02-06. The Department properly recognized this when it required that the FAS 106 Transition Obligation be reconciled for such unrecognized gains or losses. The Company now ignores the Department's decision and seeks to adjust the FAS 106 Transition Obligation included in the transition charge only for the actuarial gain associated with one employee going with the divested facilities. In no sense could this be characterized as a reconciliation of the FAS 106 Transition Obligation for unrecognized gains. Accordingly, the Department should reject the Company's method of reconciling the WMECo FAS 106 Transition Obligation and adopt the method proposed by Mr. Effron. At the time of the divestiture of the Northfield/Cabot facilities, the remainder of the WMECo FAS 106 unrecognized net gain allocable to generation should be included in the transition charge. Exh. AG-2, pp. 7, ll. 10-15.

The WMECo witnesses also maintained that, despite the fact that the WMECo transition charge includes an allocation of the NUSCo FAS 106 Transition Obligation, there should be no recognition of the actuarial gains directly related to that Transition Obligation. Exh. WM-5, p. 17. The FAS 106 Transition Obligation recovered in the transition charge, however, includes an allocation from NUSCo. Tr. 1, p. 44. As noted above, the estimate of the Transition Obligation at the time of the adoption of FAS 106, January 1, 1993, included many estimates and assumptions, and those estimates and assumptions were subject to refinement and true-up in subsequent actuarial studies quantifying the FAS 106 obligation. Thus, the Department order in D.T.E. 97-120 requires reconciliation of the NUSCo Transition Obligation no less than it requires reconciliation of the WMECo Transition Obligation. The point that no NUSCo employees transferred as a result of the divestiture is irrelevant.(5) Exh. WM-5, pp. 14, ll. 7-9 The NUSCo FAS 106 Transition Obligation must be reconciled because actuarial studies subsequent to January 1, 1993 have shown the original estimate of the FAS 106 Transition Obligation to be overstated.

As Mr. Effron testified:

A portion of the NUSCO FAS 106 transition obligation is included in the fixed component of the FAS 106 transition charge. To be consistent, the FAS 106 adjustment for divestiture should include an appropriate allocation of the NUSCO unrecognized gain or loss as of the date of the divestiture. The NUSCO FAS 106 net unrecognized gain as of the divestiture date was approximately $12,500,000. Using the same allocation method as I described above for WMECo, the allocable NUSCO FAS 106 divestiture adjustment is $96,000 (my Exhibit DJE-1, Page 3). Again, this method is precisely consistent with the method used by the Company to assign the FAS 106 transition obligation to WMECo generation.

Exh. AG-1, pp. 12-13. The Company has not substantially contested this testimony and, accordingly, the Department should include the reconciliation adjustment to the NUSCo FAS 106 Transition Obligation in the calculation of the transition charge.

The Department therefore, should order the Company to comply with its Restructuring Plan and the Department orders and flow through the full allocation of the FAS 106 actuarial gains for the generation-related employees as proposed by the Attorney General.

THE DEPARTMENT SHOULD ORDER THE COMPANY TO CREDIT TO THE TRANSITION CHARGE ALL OF THE FAS 87 -- PENSION ACTUARIAL GAINS ASSOCIATED WITH GENERATION-RELATED EMPLOYEES

WMECo has proposed to recognize a net actuarial gain in connection with its pension plan of only $1,754,000 at the time of the July 1999 divestiture. Exh. WM-5, p. 9. This credit to the transition charge is based on a study by the Company's "actuarial experts." Hewitt Associates. Id. As explained below, WMECo's proposed FAS 87 adjustment is based on a hypothetical "settlement" of its pension obligation for a small group of employees chosen by the actuary, rather than the existing FAS 87 actuarial gains as directed by the Department. Specifically, WMECo's proposal does not satisfy the Department's directions for the FAS 87 adjustment required at the time of divestiture:

[It] shall include the generation-related FAS 87 unrecognized transition obligation, prior service cost, and the unrecognized gains and losses and shall include the appropriate allocations from NUSCo and NNECo. … The amount of the adjustment will be determined at the time of each divestiture.

Order, p. 71.

On other hand, the FAS 87 adjustment contained in Mr. Effron's testimony scrupulously follows the Department's FAS 87 reconciliation standards:

I show the FAS 87 adjustment on my Exhibit DJE-1, Page 3. First, I have added together the FAS 87 unrecognized gain, unrecognized transition asset, and unrecognized prior service cost, as directed by the Department in its September 17, 1999 order in D.T.E 97-120 (Page 71). The net of these balances is $64,089,000. I allocated this amount to WMECo generation using the ratio of WMECo generation employees to WMECo total employees, 26.25%. This is the same method and same ratio that the Company used to allocate the WMECo FAS 106 transition obligation to generation. This resulted in $16,823,000 of the FAS 87 net unrecognized gain being allocated to generation.

Exh. AG-1, p. 16.

Having determined the WMECo FAS 87 net unrecognized gain allocable to generation, the Department now must determine the amount to be recognized at the time of the July 1999 divestiture. This part of the process is simply apportioning the WMECo generation-related FAS 87 net unrecognized gain between the July 1999 divestiture and the Northfield/Cabot divestiture in March 2000. Exh. AG-1, pp. 17, ll. 8-14. Mr. Effron allocated the WMECo generation related FAS 87 net unrecognized gain to the July 1999 divestiture "based on the number of WMECo employees at the sold plants in relation to the number of employees at all the WMECo generating plants." Exh. AG-2, pp. 15, ll. 6-9. This allocation method is a logical continuation of the allocation of the gain based on the number of employees, which, again, is consistent with the basic method used by WMECo to allocate the FAS 106 Transition Obligation to generation. Mr. Effron's allocation method results in $4,816,000 of the WMECo FAS 87 unrecognized gain being credited to the transition charge. Exh. AG-2, at Exhibit DJE-1R, Page 3.

Mr. Effron also included the effect of moving from the projected benefit obligation ("PBO") to the accumulated benefit obligation ("ABO"), as did the Company, in the total FAS reconciliation adjustment. The purpose of this adjustment is to recognize that WMECo would not be responsible for the effect of future wage increases on the retirees' pensions for those employees being transferred. Exh. AG-1, pp. 13-14. Mr. Effron modified the Company's quantification of this adjustment for the employee transferring to NGS, stating "This will make NGS responsible for increases in the pension obligation related to wage increases taking place after the transfer." Exh. AG-2, p. 12. This modification is appropriate and should be adopted by the Department, resulting in a "PBO to ABO" adjustment of $801,000. Exh. AG-2, at Exhibit DJE-1R, Page 3. This brings the total FAS 87 reconciliation adjustment to $5,617,000, before any allocation from NUSCo.

The Company's position is that the FAS 87 reconciliation adjustment must be based on the actuarial study commissioned by the Company. However, it became obvious during the hearings that the study prepared by Hewitt Associates was not conducted for the purpose of calculating an adjustment to the transition charge and that the study bears no relevance to the proper credit to the transition charge for FAS 87 actuarial gains. Exh. WM-5, p. 15 and Tr. 1, pp. 31-32. Mr. Baumann conceded that he did not even know "for certain" whether the Hewitt study purported to address the Attorney General's recommendation or the actual Department ruling in D.T.E. 97-120. Tr.1, pp. 50-51. Mr. Stack then testified that the Hewitt study "doesn't comply entirely with the accounting rules" and is, in effect, reflecting a settlement of WMECo's pension obligation although such a settlement did not actually take place. Tr. 1, pp. 52-56. Mr. Stack further agreed that the actuaries themselves admitted that the approach used in their study was only a "first interpretation" and that there was "latitude to apply some other approaches." Tr. 1, p. 57.

Missing from the testimony of Mr. Baumann and Mr. Stack is any explanation of how an actuarial study that reflects a hypothetical settlement of WMECo's pension obligation complies with the clear directive by the Department in D.T.E. 97-120. The WMECo adjustment is explained in Exh. AG-IR-01-05, pp. 4-5. The methodology employed by the actuaries (1) rolls forward the WMECo PBO to the date of divestiture, (2) rolls forward the PBO and ABO for the divestiture group of employees to the date of divestiture, (3) determines the funded status for WMECO based on the fair value of assets as of the date of divestiture, (4) and creates a reconciliation of funded status for the divestiture group. It is this reconciliation of the funded status for the divestiture group on which WMECo bases its proposed FAS 87 adjustment. That is, there is no recognition or allocation of the total WMECO generation-related FAS 87 unrecognized transition obligation, prior service cost, and the unrecognized gains and losses existing at the time of the divestiture, as ordered by the Department. Rather, the Company proposes an adjustment that would result from a hypothetical settlement of the pension obligation for the employees in the divestiture group based on the reconciliation of the funded status of that group of employees at the time of divestiture. This is not what the Department ordered. Nor is it consistent with the method used by the Company to allocate the FAS 106 transition obligation to the transition charge. Accordingly, the Department should reject WMECo's proposed FAS 87 adjustment.

WMECo also opposes any allocation of the FAS 87 net unrecognized gain from NUSCo.(6) The Department order in D.T.E. 97-120 required that the FAS 87 adjustment "shall include the appropriate allocations from NUSCo and NNECo." As Mr. Effron testified:

As WMECo withdraws from the generation function, NUSCO expenses will cease to be allocated to generation. At the risk of being repetitive, WMECo recognized this in allocating the NUSCO FAS 106 transition obligation to the transition charge. The same logic applies to the NUSCO FAS 87 net unrecognized gain. As I noted in my direct testimony, the Department Order of September 17, 1999 in D.T.E. 97-120 states that the effect of the divestiture on the Company's pension obligation at the time of sale "shall include the appropriate allocations from NUSCO and NNECO" (Page 71). I do not believe that the Department would have put this in its order if it didn't intend for there to be an allocation from NUSCO. The allocation from NNECO will come at the time of the nuclear divestiture. The allocation from NUSCO must be recognized at the time of the WMECo divestitures.

Exh. AG-2, p. 16.

Accordingly, it is appropriate to recognize an allocation of the NUSCo FAS 87 net unrecognized gain at the time of divestiture. Mr. Effron "allocated the FAS 87 unrecognized gain, prior service cost, and transition asset of NUSCo to WMECo generation using the same allocators that the Company used to allocate the NUSCo FAS 106 transition obligation." He "then allocated this amount to the sold group using the same method described above for direct WMECo generation employees." Exh. AG-1, p. 19. This allocation results in $1,324,000 of the NUSCo FAS 87 net unrecognized gain being credited to the transition charge at the time of divestiture. Exh. AG-2, at Exhibit DJE-1R, Page 3. This adjustment follows the Department order in D.T.E. 97-120 and is consistent with the method used by the Company to allocate the NUSCo FAS 106 transition obligation to the transition charge. The Department, therefore, should order WMECo to include this credit in its reconciliation of transition charges.

For all its criticism of the FAS 87 adjustment proposed by Mr. Effron, the Company has not asserted that his adjustment is inconsistent with the Department findings in D.T.E. 97-120. Exh. WM-5, pp. 7-14. The Company, in fact, cannot make such an assertion because Mr. Effron's proposed FAS 87 adjustment is consistent with the Department findings in D.T.E. 97-120 while the Company's proposed adjustment is not. Furthermore, his proposed adjustment is also consistent with the method used by the Company to allocate the original FAS 106 transition obligation to the transition charge and is also consistent with the method used by WMECo to allocate the FAS 106 unrecognized gain to the transition charge in its response to Record Request HD-02, Q-DTE-012 in Scenario 2, which WMECo states would "properly accomplish" such an allocation. Therefore, the Department should accept the FAS 106 adjustment proposed by Mr. Effron. The total FAS 87 reconciliation adjustment is $6,941,000. Exh. AG-2, at Exhibit DJE-1R, Page 3.

INVESTMENT TAX CREDITS

Included as offsets to the balance of generation related regulatory assets to be recovered by the Company are the balance of generation related regulatory liabilities such as the balance of unamortized deferred income tax credits. See Exh. WM-1, at Exhibit RAB-4, Page 6. As part of its 1998 and 1999 reconciliation of transition charges, WMECo has proposed two adjustments to the balance of deferred investment tax credits. First, the Company proposes to eliminate the $330,000 deferred investment tax credit balance related to the divested Fossil/Hydro assets on the grounds that continuing to amortize these ITCs would violate Internal Revenue Code normalization requirements. Exh. WM-6, p. 4. Second, the Company proposes to reduce the deferred income tax credit balance related to the retired Millstone I unit by $389,000 because the Department's decision to disallow carrying costs on the unamortized balance of its Millstone I investment required a write-down of the October 1999 Millstone 1 plant balances. The Attorney General submits that neither of these adjustments to the Company's deferred investment tax credit balances is appropriate and that they should be rejected.

Investment Tax Credits Accounting

Deferred investment tax credits ("ITCs") represent the value of earlier reductions to the Company's actual income tax expense that have not yet been flowed through to ratepayers. Exh. AG-1, p. 24. ITCs reduce the Company's income taxes dollar-for-dollar, but under "normalized" tax accounting, the value of these income tax reductions is not flowed through to consumer contemporaneously. Instead, it is deferred and amortized through credits against the Company's cost of service over the book lives of the plants. The amounts in question here are the unamortized ITC balance associated with the divested fossil/hydro assets at the time of their divestiture and the unamortized value of the ITC balance associated with the retired Millstone I nuclear unit at the time of its retirement. In essence, the Company has proposed that it be allowed to retain the unamortized balance of ITCs related to the fossil/hydro units at the time of the divestitures and that it be allowed to retain a portion of the unamortized balance of ITCs related to the Millstone I unit at the time it was retired.

The Department Should Reject The Company's Attempt To Deprive its Customers of the Value of The Unamortized ITCs Related To Its Divested Fossil/Hydro Generating Facilities

The rates paid by the Company's customers will provide a full return to the Company of the amounts it invested in the Fossil/Hydro units divested in July 1999 and, under the Department's existing ratemaking practices, customers are entitled to the full value of the associated ITCs long-ago enjoyed by the Company. Under its proposal, the Company would retain for itself and deny to its customers the value of this long deferred tax benefit. This would not only violate the Department's existing approach to ratemaking, but it would work a great inequity between the Company and its customers. Neither restructuring nor the divestiture of the underlying plants requires this result. Indeed, as Mr. Effron explained, the Company's proposal is in sharp contrast to the treatment of this issue by other Massachusetts electric utilities in regard to unamortized ITCs on the plants that they have divested. Exh. AG-2, pp. 22-23; Tr. 2, pp. 271-272, 285. As the Company's purported concerns over the potential for future adverse IRS reaction are at best exaggerated and, consistent with the legislative requirement of "maximum mitigation," are better only if realized, the Attorney General submits that the Department should reject the Company's proposal.

The sole basis for the Company's professed belief that continuing to reflect the amortization of ITCs in rates after divestiture would violate normalization requirements is its analysis of one Private Letter Ruling ("PLR") from Internal Revenue Service.(7)(8) Exh. WM-6, Attachment and Exh. AG IR-02-032; Exh. AG-1, pp.17, ll. 17-19; Exh. AG-2, p. 23, ll. 5-13). While the PLR does suggest that continuing to amortize ITC balances after divestiture could, in some circumstances, violate normalization requirements, it must be emphasized that a PLR, is nothing more than advisory communications prepared by individuals in the Office of the Assistant Chief Counsel for the IRS and that it does not have the force of law. Exh. AG-2, Attachment DJE-2 (Opinion of the Commonwealth Court of Pennsylvania in Continental Telephone Company of Pennsylvania v. Pennsylvania Public Service Commission, (Case Nos. 598 C.D. 1986 and 599 C.D. 1986)); Idaho Power Company v. Commissioner of Internal Revenue, 447 F.2d 688 (9th Cir. 1973), rev'd on other grounds 418 U.S.1, 94 S.Ct. 2757, 41 L.Ed.2d 535 (1974). Indeed, the Company's own witnesses acknowledged that a PLR is not binding on anyone other than the requesting taxpayer and that there is no announced IRS position on the appropriateness of continuing to rate normalize unamortized ITCs associated with plants that have been divested. Tr. 1, pp. 72, 80-82, 92. The Attorney General submits that in these circumstances, the Department should continue to require that the Company's customers receive the long deferred value of past tax benefits enjoyed by the Company. Any other result offends logic and would deny WMECo's customers the benefits which have been accorded to the customers of every other Massachusetts electric utility.

Finally, as Mr. Effron explained, even if the Internal Revenue Service were to conclude that continuing to require a flow through of the value of unamortized ITCs violates tax normalization, which is extremely unlikely, since nothing remotely like this has ever happened in the more than thirty years that the normalization requirements have been on the books, consumers would be no worse off than if Department allowed the Company's proposal. Tr. 1, pp. 70-76; Tr. 2, p. 270. Requiring WMECo to recapture the remaining unamortized investment tax credits, the "penalty" for the violation of this normalization requirement, would have the same effect on the transition charge as the Company's proposal to keep the investment tax credit for itself. Id. To consumers, the only distinction between the Company's proposal and an implausible finding of a normalization violation, is who gets to retain the value of tax benefits to which they are otherwise entitled: the Company or the U.S. Treasury. The Department should reject the Company's proposed adjustment to its balance of deferred Investment Tax Credits.

There Company's Proposed Adjustment to Millstone I ITC Balances is Without Merit

The Department should reject WMECo's proposal to reduce the balance of deferred Millstone I investment tax credits by $389,000 to reflect a write-off resulting from the denial of carrying costs on unamortized Millstone 1 investment balances. Exh. AG-1, p. 21. The appropriate balance of deferred investment tax credits is not affected in any way by the allowance of a return on the unrecovered Millstone I balance. As a result of the Department's denial of a return on the unamortized

Millstone 1 investment, a write-off of the Millstone 1 plant balance was made for financial reporting purposes,(9) but not for purposes of calculating the Company' transition charge. Id., p. 25. The full unamortized balance is being amortized in the fixed component of the transition charge. Because the amortization of the investment tax credit serves as an offset to the amortization of the plant balance, there is no reason to adjust the balance of the investment tax credit being amortized because of the disallowance of a return on the Millstone 1 plant balance.

On cross-examination, Mr. Stack admitted that it was the plant investment in Millstone 1 still being recovered through the transition charge that generated the investment tax credit, not the Millstone 1 return that was disallowed by the Department. Tr. 1, pp. 96-97. He also agreed that the amortization of the investment tax credit has, in effect, been treated as an offset to depreciation expense. Id., pp. 97-98. As the Millstone 1 amortization is still in the transition charge, the amortization of the investment tax should continue to be an offset to the Millstone 1 amortization. Therefore, the Department should reject the proposed reduction to the Millstone 1 investment tax credit balance, and the amortization of those investment tax credits should continue as it did prior to the Company's adjustment.

THE CARRYING COSTS ON THE COMPANY'S TRANSITION COSTS SHOULD BE UPDATED FOR CHANGES IN ITS CAPITAL STRUCTURE

In his direct testimony, Mr. Effron proposed to adjust the 1998 and 1999 transition costs to reflect updates to the capital structure used in calculating the return allowance in the fixed component of the transition charge. Exh. AG-1, pp. 30-31. At the hearings, the Company concurred in part with Mr. Effron's proposed adjustments, agreeing that the 1998-1999 transition charges should be reduced by approximately $650,000 to reflect updates to the capital structure. Tr. 1, pp. 10 B11. However, the Company did not agree with Mr. Effron's recommendation to include short-term debt in the capital structure to the extent that it replaced long-term debt retired in 1999. Exh. WM-5, p. 25.

Mr. Effron is not proposing to include all short-term debt in the capital structure, but only the short-term debt that replaced the long-term debt retired in 1999. Exh. AG-1, p. 31. The reason that Mr. Effron is proposing this adjustment is that "the sum of the common equity, preferred stock, and long-term debt over the course of 1999 is less than the amount needed to finance the Company's net operating assets over the year, (so) the effect of the short-term debt that replaced the retired long-term debt should be recognized in determining the capital structure ratios." Id., p. 30. The Company did not dispute the fact that the sum of the common equity, preferred stock, and long-term debt over the course of 1999 was less than the amount needed to finance the Company's net operating assets over the course of the year.

The only reason offered by the Company to reject Mr. Effron's proposal is that the capital structure ratios without short-term debt "demonstrate a reasonable capital structure." Exh. WM-5, Pp. 25, ll. 7-8. The Company offered no evidentiary support for this conclusory statement. In fact the debt/equity ratio proposed by Mr. Effron for 1999, with short-term debt in the capital structure, is almost exactly the same as the debt/equity ratio in 1998 proposed by the Company after the updates to which it agreed. As the Company finds its updated debt/equity ratio in 1998 to reasonable, then it must necessarily follow that the debt equity ratio proposed by Mr. Effron for 1999 is reasonable. Therefore, in calculating the return allowance in the fixed component of the transition charge for 1999, the Department should order WMECo to use the 1999 capital structure shown on Exh. AG-2, at Exhibit DJE-1R, Page 6A. This capital structure should also be used to calculate the rate of return on the balance of any transition charge over or under recovery in 1999.

TARIFF T-9 CHARGES

Introduction

On July 23, 1999, WMECo sold the West Springfield and associated hydro generating facilities to Consolidated Edison Energy Massachusetts, Inc. ("ConEd"). The total sales price was $47,000,000, to which WMECo made net adjustments of $5,961,000, leaving a net proceeds balance of $41,039,000. Exh. WM-1, Att. Exhibit RAB-4, p. 4B. As part of that transaction, WMECo claims to have sold "an intangible transmission asset for $2.5 million" to ConEd. Baumann Rebut, p. 4. According to WMECo the asset was "the right to use interconnection facilities that would be needed to transmit the power generated from the divested plants to the electric grid. " Id., pp. 4-5. This $2.5 million has been deducted from the Company's calculation of the net proceeds. See "Deductions to Purchase Price," a $2.5 million line item for "Tariff T-9 Charges." Exh. WM-1, Att. Exhibit RAB-4, p. 4B. The Company proposes to amortize these proceeds over ten years as credits to its transmission revenue accounts.

WMECo Seeks To Deny Customers The Full Benefits of the Fossil/Hydro Divestiture To Which They Are Entitled
WMECo has allocated $2.5 million of the net proceeds to some newly created "intangible" right to interconnect the divested generating facilities to the WMECo transmission system. As stated above, the amortization will appear as credits in its transmission revenue accounts. Therefore, unless the Company instantaneously files a transmission rate case at FERC, these "credits" will flow to shareholders, rather than customers, as required by the Restructuring Act and the Transition Charge formula approved in D.T.E. 97-120.

The Restructuring Act requires that all proceeds from any such divestiture and sale of generation facilities . . . shall be applied to reduce the amount of the selling electric company's transition costs. G.L. C. 164, §1A(b)(3). The Formula for Calculating Transition Charges ("Formula"), approved by the Department in D.T.E. 97-120, provides for only certain specified reductions to proceeds from divestiture: (1) deductions for capital additions committed after December 31, 1995, (2) the book value of fuel inventory, materials and supplies, and (3) reasonable transaction costs. Exh. AG-2, p. 4, ll. 9-17 and Tr. 1, pp. 24-25. The Formula does not provide for "intangible" rights.

In essence, the Company is seeking to modify its approved Restructuring Plan without any of the appropriate legal or factual grounds. The assignment of a part of the proceeds to prepayment of the "Interconnection Facilities Charge" for ConEd's perpetual use of "Interconnection Facilities" is simply an allocation of the proceeds between the seller and buyer of the facilities made for income tax purposes and does not change the substantive nature of the amounts received by WMECo as proceeds from the sale of the facilities. WMECo's "characterization" of this item as "transmission related" cannot control the treatment of proceeds for the purpose of calculating the Company's transition charge. Exh. AG-1, pp. 7-8; Exh. AG-2, pp. 3-5; Exhibit AG IR-03-10, Second Amendment to Purchase and Sale Agreement. The fact that this allocation is done for income tax accounting purposes does not require the Department to adopt this treatment for ratemaking purposes.

WMECo's proposed treatment is inconsistent with its obligation to take "all reasonable steps to mitigate to the maximum extent possible the total amount of transition costs that will be recovered and to minimize the impact of recovery of such transition costs on ratepayers in the commonwealth." G.L. c. 164, § 1G(d)(1). The Company's proposal to record these proceeds as revenues and amortize them as transmission revenues effectively denies customers the benefits of proceeds to which they are entitled to under the Restructuring Act and the approved transition charge Formula. The Company will not provide carrying costs on the unamortized balance due customers, so the customers will lose the time value of money. Customers will only benefit from the credits when, the Company files new transmission rates that incorporate such credits.(10)

WMECo also claims that there is no valid basis for treating the "Tariff T-9 Charges" differently from any of the other reductions to the purchase price on Exhibit RAB-4, p. 4B.(11) However, this item is easily distinguishable from the other reductions. The other items represent either cash expenditures directly associated with the divestiture or cash investments previously made by WMECo that were transferred with the plants. There is no such cost attributable to the Tariff T-9 prepayment for access to the transmission system in perpetuity. Exh. AG-2, pp. 2-3. As Mr. Effron testified:

Unlike the other deductions from the proceeds, WMECo did not recognize any expense associated with this item. WMECo simply removed $2.5 million from the divestiture proceeds and credited that amount to deferred transmission revenue, thereby keeping the $2.5 million for itself, rather than including it in the residual value credit for the benefit of customers. I can find nothing in the Department's orders in D.T.E. 97-120 or in the Company's approved restructuring plan that allows it to retain a part of the divestiture proceeds in this manner.

Id., p. 3, ll. 12-18.

The Department should reject WMECo's attempt to reduce the net proceeds from the sale of its generating units and order that the Company use the $2.5 million to reduce it's transition costs.

GENERATION OPERATING COSTS IN THE VARIABLE COMPONENT
There are four issues with regard to the generation operating costs included in the variable component of the transition charge: (1) post-1995 capital additions; (2) FAS 106 expense; (3) allocation of costs to Madison/Other sales; and (4) the margin on Tariff 7 sales.

The Department Should Reject The Company's Proposal To Recover A Return on And of Post 1995 Capital Additions Through the Variable Component of the Transition Charge
In its filing, the Company has included a return on and of capital additions to plant in service taking place after 1995 in the generation operating costs that it seeks to recover through the variable component of the transition charge. This proposal is inconsistent with Company's the Department approved Restructuring Plan and should be rejected.

The Formula for Calculating Transition Charges specifies that the capital additions to non-nuclear generating assets committed after December 31, 1995, demonstrated to be prudently incurred, will be taken as a reduction to the proceeds from the divestiture of generating assets in the calculation of the residual value credit. For nuclear capital additions, the Formula provides for the return on and of nuclear capital additions incurred after 1995 to be included in the nuclear PBR. There are no other provisions in the Formula that provide for the recovery of post-1995 capital additions. Exh. AG-1, pp.27-28. Specifically, there is no provision for a return on and of these capital additions as part of generation operating costs.(12) Nevertheless, the Company has proposed the recovery of these costs through the Variable Component of the Transition Charge.

The Company's witness, Mr. Baumann did not even discuss the recovery of post-1995 capital additions for the fossil generating plants in his testimony. Instead, he attempted to boot-strap all post-1995 capital additions into his arguments that the post-1995 nuclear capital additions are recoverable. With respect to the nuclear capital additions, Mr. Baumann testified that there are "several provisions for the recovery of post-1995 nuclear capital additions." Exh. WM-5, p. 18. First, he noted that "[t]he PBR mechanism collects a level of post-1995 nuclear capital additions set at a cost benchmark, at the peer-average level." Exh. WM-5, p. 18. Any revenues from the sale of the Millstone plant's capacity and energy are reduced by peer-average operating costs including return of and return on capital additions incurred after December 31, 1995. That section of the Formula, however, clearly states that the PBR for Millstone 2 and 3 "will commence upon the termination of the NUG&T" and, since the NUG&T was still in effect in 1998 and 1999, this section was inapplicable to the reconciliation of transition costs for those years. See HD-03, Q-DTE-16, Bulk, Section 1.2.3(I).

As the reconciliation of transition charges for 1998 and 1999 is what is before the Department, the section of the Formula that Mr. Baumann cited as providing for recovery of the return on and of the post 1995 capital additions is irrelevant. Accordingly, the Department should reject the Company's argument and should exclude the return on and of the post 1995 capital additions from the generation operating costs recovered in the variable component of the transition charges.

The Department Should Ensure That The Company Does Not Double Recover Its FAS 106 Expense in Generation Operating Costs

In its filing the Company included generation related administrative and general expenses in the generation operating costs which contain employee benefits, including FAS 106, post retirement benefits other than pensions. The Company is also separately recovering the generation related portion of the FAS 106 transition obligation as a regulatory asset. Thus, WMECo is double recovering the generation related FAS 106 expenses. During the hearings, the issue of the double-recovery of the Company's generation-related FAS 106 expense was partially resolved. Mr. Baumann stated that he agreed with the Attorney General's position that there was a double-counting of the amortization of the FAS 106 transition obligation in the generation operating costs in 1998 and 1999 and that the 1998 and 1999 transition costs should be reduced by $1,248,000 to eliminate this double counting.

There is still disagreement, however, concerning the issue of double-counting of the return component of the FAS 106 expense in 1998 and 1999. Tr. 1, pp. 12-13. As Mr. Effron described in his testimony, the double-counting is occurring here as well.

The Company included generation related administrative and general expenses in the generation operating costs. As explained in the response to AG-2-13, these administrative and general costs include employee benefits, among other expenses. Employee benefits include post retirement benefits other than pensions charged to expense pursuant to FAS 106. WMECo is separately recovering the generation related portion of the FAS 106 transition obligation as of March 1, 1998. This recovery includes a return on and of the transition obligation. To avoid a double recovery of the FAS 106 transition obligation, the amount being recovered separately should be removed from the administrative and general expenses included in the generation operating costs.

Exh. AG-1, p. 28.

Mr. Effron elaborated further in his testimony on cross-examination:

The FAS 106 cost included in operating expenses includes amortization of the transition obligation and a return on the accumulated post-retirement benefit obligation. So there already is included in the expenses that go into the generation/operating costs amortization of the transition obligation and a return component as well. And to properly eliminate the double-count, the full amount of the adjustment here has to be made.

Tr. 2, pp. 279-280.

Mr. Bauman did not challenge or object to Mr. Effron's testimony on this issues. The Company has offered no defense or counter-arguments to Mr. Effron's analysis. Therefore, in order to completely remove any double-counting, the Department should adopt Mr. Effron's proposed adjustment and order WMECo to remove the return component of the FAS 106 expense. As shown on Exh. WM-1, Exhibit RAB-4, Page 12C, the return component for 1998 was $510,000, and the return component for 1999 was $545,000.

Customers Should Receive The Benefits Of The Madison And Other Wholesale Power Sales If TheyAlso Are To Receive The Burden

The Company has included costs related to wholesale power transactions in the Variable Component of the Transition Charge, but has failed to credit customers with the revenues associates with the sales. Although WMECo has removed the energy costs associated with the Madison power sales from the generation operating costs, it has not recognized capacity revenue and energy revenue in excess of cost associated with that contract. Since all of the generation costs are included in the transition charge, all the revenue attributable to those sources should also be recognized. Exh. AG-1, p. 29. The Company's retail customers are bearing all the fixed costs associated with the supplying the Company's wholesale contracts, and the Department should also assign all the benefits of these wholesale contracts to them as well.

In support of the Company's position, Mr. Baumann testified that

in the past, none of the costs associated with serving the wholesale Madison contract or other wholesale contracts at issue were deemed to be retail generating costs. None have ever been included in generating costs that WMECo's retail customers supported.

Exh. WM-5, p. 21. The problem with Mr. Baumann's argument is that the costs associated with serving the wholesale Madison contract are now being recovered through the transition charge being paid by retail customers. As Mr. Effron testified,

if none of the costs associated with the wholesale contracts are deemed to be retail generating costs, then there should be an allocation of the fixed generating costs to those contracts in determining the retail responsibility for transition costs. The Company has made no such allocation. Therefore, to be consistent, all the revenue from these sales should be credited against the generation operating costs. I would further note that this treatment is consistent with the Company's filed Restructuring Plan, Section 1.1.3(b)(ii) of the Formula for Calculating Transition Charges regarding lost revenues, which makes reference to "market revenues" as the measure of the offset to lost revenues. Having said that, I would agree that a reasonable alternative to my proposal would be to allocate some part of fixed generating costs, including operation and maintenance expense and plant costs, to wholesale sales, thereby reducing the retail responsibility for the recovery of transition costs. However, it is clearly unreasonable for the Company to recover all of the fixed generating costs from retail ratepayers while keeping for itself the margin on its wholesale sales.

Exh. AG-2, p. 19.

The Company has not allocated any fixed generating costs whatsoever to wholesale sales. The only alternative then is to include the margin on wholesale sales in the revenues that are offset against the generation operating costs. This will provide proper mitigation to the wholesale fixed generating costs that are included in the transition charge. Therefore, the 1998 transition costs should be reduced by $487,000 and the 1999 transition costs should be reduced by $549,000, as shown on Exh. AG-2, at Exhibit DJE-1R, Page 5.

The Margin on Tariff 7 Sales Should Be Credited Against Generation Operating Costs
The Company has eliminated both the revenue and purchased power costs associated with off-system Tariff 7 sales. Since all of the generation costs are included in the transition charge, the operating margin attributable to those sources should also be credited against the generation operating costs.

The issue of the Margin on Tariff 7 Sales appears to have been partially resolved in the Company's responses to record requests in this proceeding. Mr. Effron proposed to reduce 1998 transition costs by $833,000 and 1999 transition costs by $253,000 to recognize the margin on Tariff sales. Exh. AG-2, at Exhibit DJE-1R, p. 5. In the response to Record Request HD-02, Q-DTE-013, the Company agreed that $791,000 included in Tariff 7 revenues "should be credited to customers". This leaves the amounts in dispute at $42,000 in 1998 and $253,000 in 1999.

If the margins related to the Tariff 7 sales are reasonably related to WMECo generation activities, as Mr. Effron testified they are, then those margins must be used to mitigate the Company's transition costs. Exh. AG-1, pp. 29, ll. 15-21. WMECo has presented no evidence that would suggest that the Tariff 7 revenues relate to any activity other than its generation function. Therefore, the transition costs should be reduced by $42,000 in 1998 and $253,000 in 1999 for the margins on tariff 7 sales, in addition to the $791,000 that the Company has already conceded.

THE DEPARTMENT SHOULD REQUIRE THE COMPANY TO MAINTAIN THE USE OF THE RESIDUAL VALUE CREDIT AS ORIGINALLY PROPOSED IN THE COMPANY'S RESTRUCTURING PLAN
The Company proposes to eliminate the use of the Residual Value Credit. This proposal, however, ignores the Formula for Calculating Transition Charges in the restructuring plan approved by the Department in D.T.E. 97-120 and should be rejected.

The Formula is absolutely clear:

WMECo will divest its non-nuclear generating assets. Within three months after the completion of each divestiture, WMECo shall implement a Residual Value Credit as a direct offset to the Transition Charge authorized under this Agreement.

See Formula for Calculating Transition Charges, Section 1.1.3(b), as in response to Record Request, HD-03, Q-DTE-016. As Mr. Baumann conceded on cross-examination, this section leaves no room for any alternative to the implementation of a Residual Value Credit (Tr. I, p. 68, ll. 3-6).(13) WMECo must implement a Residual Value Credit. Even if the Company hypothetically had the option of not implementing the RVC, which it does not, there are sound policy reasons why the Department should require the RVC implementation. First, it would eliminate any basis for the Company's claim for a potential violation of normalization requirements regarding the continued amortization of investment tax credits:

The generating plant, with associated amortization and return, would remain as an element of the fixed component, according to the Formula, and the residual value credit would be a separate element of the Fixed Component. WMECo would continue to recover from customers for the cost of the plant, and the credit for the proceeds would be accounted for separately. As the Company would continue to recover the cost of the plant, the basis for any claim of violating normalization rules would disappear.

Exh. AG-1, pp. 32-33.

Mr. Effron expanded on this theme in his surrebuttal testimony:

As I explained in my direct testimony, by continuing to amortize the generating plant over its original schedule, any potential concern about normalization violations with regard to continuation of investment tax credit amortization should be removed. If the amortization of generating plant continues to be a component of the transition charge, then a parallel treatment of the investment tax credit cannot constitute a normalization violation.

Exh. AG-2, pp. 20-21.

Second, by accounting for the proceeds of the divestiture separately, the verification of the accounting for the divestiture is much more straightforward:

there should be no substantive direct difference between the WMECo method and the RVC method. However, it is not possible to tell if there is any such difference from the Company's filing. For example, looking at Exhibit RAB-4, Page 11B, the deferred tax balance as of July 1, 1999 changes from the prior date because of the divestiture. It is not, however, possible to tell from that schedule how much of the change is due to the divestiture and how much is due to the normal reversal of deferred taxes or what the effect of the divestiture on the deferred tax balance is. In other words, one cannot tell if the Company has properly incorporated the effect of the divestiture simply by looking at the schedules.

Exh. AG-2, p. 20.

Demonstrating a fine sense of irony, Mr. Baumann explained "for simplicity, WMECo elected to reduce the amortization period by immediately reducing generation assets, in lieu of a RVC." Exh. WM-5, pp. 26, ll. 12-13. Mr. Effron demonstrated why the Company's method of accounting for the divestiture is totally at odds with the worthy goal of simplicity:

Besides appearing on Page 4 of Exhibit RAB-4, the effects of the divestiture also appear on pages 5, 6, 11, 11A, 11B, and 12. In many cases it is not clear what the exact effect of the divestiture on the balances on those pages is. It would be much less complicated to leave the amounts on those pages unchanged once they are approved by the Department and to record the effects of divestiture in a separate RVC, as set out in the Company's own Formula for Calculating Transition Charges. The RVC will make it much easier to analyze the effect of the divestiture on the transition charge and to verify that the divestiture is being accounted for correctly. All other electric utilities in Massachusetts have implemented a residual value credit. WMECo should be no different.

Exh. AG-2, p. 20.

In summary then, there are four sound reasons why the Department should require WMECo to implement a Residual Value Credit in the calculation of the transition charge: 1) WMECo is required to implement a Residual Value Credit by the terms of the restructuring plan approved by the Department; 2) the Company will eliminate any potential concerns regarding violations of normalization requirements from continued amortization of investment tax credits; 3) it will be easier to analyze the effect of the divestiture on the transition charge and to verify that the divestiture is being accounted for correctly; and 4) all other electric utilities in Massachusetts have implemented a residual value credit, and WMECo should be no different. WMECo has offered no reason why its proposed method of accounting for the proceeds from divestiture is superior. Accordingly, the Department should order WMECo to abide by the terms of the approved restructuring plan and implement the Residual Value Credit in its transition charge reconciliations.

FORM OF FUTURE RECONCILIATION FILINGS

WMECo is proposing that all future reconciliation filings show only actual transition costs versus transition revenues for the given reconciliation period. Exh. WM-1, p. 16. As Mr. Effron testified, such a presentation would be inadequate:

At a minimum, each future reconciliation filing should also show the actual transition costs versus transition revenues for all periods preceding the period being reconciled. This is necessary for verification that any modifications ordered by the Department have been properly incorporated into the reconciliation. For example, if the Department accepts any of the recommendations presented above, the reconciliation for 1998 and 1999 will be affected. The next reconciliation should show transition costs and transition revenues for 1998 and 1999 with any Department ordered modifications included and a recalculation of the reconciliation balance existing as of the end of 1999. Similarly, each future reconciliation filing should provide the information necessary to verify the proper treatment of corrections to the reconciliation for prior years.

Id. In addition, future transactions, such as divestitures and securitization, will affect the transition charge path in future years. The reconciliation filings should continue to show projections of transition charges to the end of the recovery period. This will provide information that could be useful in assessing different potential paths for transition charge recovery in the event such differing options become available. Exh. AG-1, pp. 36-37.

The Company did not rebut Mr. Effron's recommendation for the form of future reconciliation filings. The Department should order WMECo to present future reconciliation filings in the form proposed by Mr. Effron.

CONCLUSION
Wherefore, for all of the foregoing reasons, the Department should approve only recovery of transition charge costs consistent with the arguments set forth in this brief.

Respectfully submitted,

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1. On January 5, 2000, the Department issued an Order in D.T.E. 97-120 setting the level of transition charge revenues recoverable by the Company and defining the types of transition costs recoverable for the period March 1, 1998 through December 31, 1999.

2. The so-called "Transition Obligation" is the balance of the Company's liability for post-retirement benefits other than pensions that was recognized when the Company was required in 1993 to change from the cash to the accrual method of accounting for such expenses. See Western Massachusetts Electric Company, D.T.E. 97-120, pp. 63-64 (1999).

3. Not surprisingly, the inconsistent methods employed by WMECo result in maximum costs and minimum benefits being included in the transition charge. For example, 26.25% of the WMECo FAS 106 Transition Obligation, or approximately $6.4 million, is allocated to generation and included in the transition charge (Exhibit AG IR-01-25). The total WMECo FAS 106 unrecognized actuarial gain as of July 23, 1999 was $6.7 million (Exhibit AG IR-02-06). Yet, despite the fact that approximately 30% of the

WMECo generation employees were at the stations divested in July 1999 (Tr. I, pp. 37-39), the Company is proposing to include a reconciliation adjustment of only $60,000 (Tr. I, p. 11), less than 1% of the unrecognized actuarial gain as of July 23, 1999, in the transition charge. It is obvious that this $60,000 credit to the transition charge is grossly inadequate, given the Transition Obligation included in the transition charge and the magnitude of the actuarial gains directly related to that Transition Obligation.

4. The Company witnesses feign ignorance of what it was that the Department ordered to be reconciled. Company Witness Stack suggested that in reviewing page 66 of the Department order in D.T.E. 97-120, he did not "see the transition obligation discussed at all" (Tr. I, p. 45). From a reading of the whole section of the Department order on FAS 106, however, it is clear that when the Department refers to the "FAS 106 balance" on page 66, it means the FAS 106 Transition Obligation. Indeed, the FAS 106 Transition Obligation is the only FAS 106 balance included by WMECo in regulatory assets recovered through the transition charge - a fact which eluded both Mr. Stack and Mr. Baumann at the hearing.

5. Although no NUSCo employees transferred with the divestiture, concurrent with the WMECo restructuring there has been a significant reduction in the number of NUSCo employees. Tr. 1, pp. 86-87. Were this point relevant, the departures would necessitate the same sort of adjustment as would a direct transfer.

6. WMECo's position is that there should be no FAS 87 allocation from NUSCo because no NUSCo employees were transferred at the time of divestiture. Exh. WM-5, p. 7. As Mr. Effron explained, however, this is irrelevant. Exh. AG-2, p.16. Were it relevant, then it should be noted that concurrent with the WMECo restructuring, there has been a significant reduction in the number of NUSCo employees, and this reduction in the number of employees would require the same sort of FAS 87 adjustment as would a direct transfer of employees. Tr. 1, pp. 86-87.

7. It is interesting to note that in AG IR-02-032, the Company was asked to provide "any available documentation" that supports its position that the flowing back the balance of investment to ratepayers would be a violation of normalization requirements. The Company responded with certain responses to information requests it had provided in D.T.E. 97-120. In particular, the Company included a response in D.T.E. 97-120 to a request that it provide "references, interpretations, etc. which the Company used to form its opinion". The only such reference was a PLR from 1987. Mr. Stack attached another PLR from 1999, also purported to support the Company position, to his rebuttal testimony. The Company had declined to include the PLR from 1999 in its response to AG IR-02-032, even though the PLR had been issued at the time of the response and was available to the Company. Tr. 1, pp. 77-78.

8. Although the Company also referenced the fact that the Fossil/Hydro plants sold at a price above book value, Mr. Effron explained that that is not relevant to the flow back of the investment tax credit: the proceeds from all of the divestitures will not fully offset the cover the unrecovered costs of the Company's generating plants. Tr. 2, pp. 264-265. Cf. G.L. c. 164, §1G(d)(1)(iv) (value and application of mitigation separate and independent of determination of recoverable transition costs).

9. A utility is required to write-down the value of plant assets, if the regulatory body disallows a return on that asset. See FAS 110. The write-down reflects the present value of the expected recoveries from customers. However, the utility=s earnings will be written up in the future as it recovers the balance from customers.

10. This $2.5 million is not being used to lower transmission costs on a kWh basis to WMECo's customers.

11. No other Massachusetts utility has attempted to employ a such a ratemaking device to unjustly enrich shareholders and the expectation of "reasoned consistency" precludes such a result here. Boston Gas Company v. Department of Public Utilities,

367 Mass. 92, 104 (1975).

12. In addition, in its compliance filing in D.T.E. 97-120, the Company did not include a return on and of post 1995 capital additions in generation operating costs.

13. In an attempt to change the Company's obligation to implement a Residual Value Credit ("RVC"), Mr. Baumann relies on another section of the Formula which he takes out of context in his rebuttal testimony. "Paragraph 1.1.3 (b) (v) of the Formula states that proceeds from divestitures may be applied through an RVC or be used to reduce the amortization period." Exh. WM-5, pp. 26, ll.10-11. The whole sentence from which Mr. Baumann took the quoted fragment reads:

The Net Proceeds from the divestiture including amortization and the pre-tax return specified in Section 1.1.2 on the unreturned credit balance net of tax impacts shall be credited to the Fixed Component in equal annual amounts over the period commencing on the date the Residual Value Credit is implemented through December 31, 2009 or be used to reduce the amortization period.

See Formula for Calculating Transition Charges, Section 1.1.3(b)(v), as in response to Record Request, HD-03, Q-DTE-016.

No fair and complete reading of this provision could possibly interpret it to mean that the reduction to the amortization period could serve as an alternative to the Residual Value Credit. The sentence still refers to "the date the Residual Value Credit is implemented," a part of the sentence conveniently omitted by Mr. Baumann, leaving no doubt that the Company must implement the RVC. Rather, the alternative of reducing the amortization period is an available option for use of the RVC that the Company must nonetheless implement.